

RatingsDirect®

Summary:

Phoenix Civic Improvement Corp., Arizona Phoenix; Water/Sewer

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Summary:

Phoenix Civic Improvement Corp., Arizona Phoenix; Water/Sewer

Credit Profile

US\$381.215 mil jr lien wtr sys rev rfdg bnds (Phoenix) ser 2016 due 07/01/2039

Long Term Rating

AAA/Stable

New

Phoenix Civ Imp Corp, Arizona

Phoenix, Arizona

Phoenix Civ Imp Corp (Phoenix) jr lien wtr

Long Term Rating

AAA/Stable

Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Phoenix Civic Improvement Corp., Ariz.'s series 2016 junior-lien water system revenue refunding bonds, issued for Phoenix. We are also affirming our 'AAA' rating on the water system's junior-lien revenue bonds. The ratings reflect the combination of extremely strong enterprise and financial risk profiles. The outlook is stable.

The enterprise risk profile reflects our view of the water system's:

- Role as the anchor and namesake city in the broad and diverse Phoenix-Mesa-Scottsdale metropolitan statistical area's (MSA) strong economy;
- Low water rates, as well as low overall bill when including the city's sewer services; and
- An operational management assessment we view as 'strong', indicating the highest alignment between operations and strategic goals.

The financial risk profile reflects our view of the system's:

- Extremely strong all-in debt service coverage (DSC) as well as liquidity and reserves;
- Capital plan that management anticipates funding over 80% from internally generated revenues or shared costs, making it likely that the financial results are sustainable well into the future; and
- Strong financial management practices and policies.

The system has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the system's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues, allowing us to rate the junior lien above that of the U.S. We have applied the primary utility revenue bond criteria to determine the system's general creditworthiness (issuer credit rating) and have applied this rating as the implied senior-lien rating; the water system currently does not have any senior-lien rating, but the master resolution is still active and therefore could be utilized to issue debt that would come ahead of the approximately \$1.2 billion in junior-lien water system revenue bonds currently outstanding. If senior-lien debt were to be issued, we would therefore make a one-notch distinction between the senior and junior liens.

We understand that bond proceeds will be used to refund the water system's series 2009 junior-lien revenue bonds for savings purposes. The bonds are secured by a pledge of the water system's net revenues. There is no debt service reserve fund (DSRF). However, given the system's substantial liquidity and management's policy to maintain cash on hand equivalent to at least the upcoming debt service payment, we do not view the lack of a DSRF as a credit weakness.

Enterprise risk

The water system provides service to the sixth-largest city in the U.S, serving almost 419,000 mostly residential accounts across a 540-square-mile service area. While the housing market across Arizona, including in the MSA, suffered during the recent recession, the Phoenix economy has outperformed the nation's during the recovery and continues to grow. The S&P Corelogic Case-Shiller home price index as of July 2016 shows that home prices have increased every month since bottoming out in early 2011, although they remain below prerecession levels. The city's broad and diverse service area--home to 1.53 million people--includes major employers in the health care, financial services and aerospace sectors. Additionally, the city serves as the state capital and the economic engine for the state. These factors have helped keep unemployment low, most recently at 4.8% as of September 2016. Median household effective buying income is 88% that of the U.S. There is no customer concentration, as the 10 leading users account for less than 5% of water system revenues.

Phoenix operates and jointly owns a total of five water treatment plants, one of which is jointly owned with the city of Mesa. The city has benefitted from the fact that much of its growth has happened in recent decades, with relatively newer infrastructure. As such, its distribution system is in good condition with very favorable nonrevenue water losses and no existing or looming environmental mandates. We view these as credit positive given that we have observed lack of compliance is often correlated with large increases in capital investments. This has helped keep the overall bill very affordable. Even when including the separate city sewer bill, a typical residential monthly water and sewer bill is about \$60, or, in our view, a very affordable 1.8% of median household effective buying income.

Based on our operational management assessment, we view the water system to be a '1' on a scale of 1-6, with '1' being the strongest. In our opinion, this indicates the strongest alignment of operations and organizational goals. The strong OMA includes a system that overall is in good condition with low nonrevenue water, from the combination of very proactive preventive maintenance and its relatively young age. Even given the desert climate, the city has an effective 100-year water supply between the Salt River Project and the Central Arizona Project. Still, aggressive water conservation measures and demand-side management has been the norm for decades. Phoenix also has ample treatment capacity from city-owned plants and a regional jointly-owned facility. The city council also approved multiyear rate increases earlier in 2016, which we also view as credit positive as being reflective of apolitical long-term planning.

Consistent with our criteria "Methodology: Industry Risk", published Nov. 19, 2013, we consider industry risk for the system to be very low, the most favorable assessment possible on a '1' to '6' scale, with '1' being the best.

Financial risk

In our opinion, the water system's financial risk profile remains a clear credit strength. Estimated fiscal 2016 all-in DSC, which includes a small amount of G.O. debt supported by the water system and treating operating transfers out of the

water fund as if they were operating expenses, was 1.87x by S&P Global Ratings' calculation. Total liquidity is an evident strength as well, with the approximately \$165 million in total available cash and investments equivalent to roughly 300 days of operating expenses estimated for fiscal 2016; one of the many internal financial policies established for the water system include setting rates to achieve annual DSC of at least 2x and maintaining cash reserves equivalent to at least the upcoming year's debt service payment, partially in lieu of maintaining a formal DSRF.

Because of a long history of proactive asset management and preventive maintenance, the capital improvement plan (CIP) of \$785 million from fiscal 2017 through 2021 contains only limited use of additional debt; management anticipates funding over 80% of the capital commitments from internally generated revenues, including cost-sharing projects related to the jointly-owned water treatment plant.

Based on our financial management assessment, we view the water system to be a '1' on a scale of 1-6, with '1' being the strongest. An FMA of 'strong' indicates that practices are strong, well embedded, and likely sustainable. The financial team maintains most of the best practices deemed critical to supporting credit quality and these are well embedded in the government's daily operations and practices. Formal policies support many of these activities, adding to the likelihood that these practices will be continued into the future and transcend changes in the operating environment or personnel. This includes regular monitoring and reporting of budget-to-actual performance, robust capital planning and asset management, and a financial forecast that is based on realistic and conservative assumptions that make it likely that actual performance will beat expectations.

Outlook

The stable outlook reflects S&P Global Ratings' expectation of continued strong financial performance levels given management's lack of additional debt plans, which we believe makes it likely that the financial risk profile can be perpetuated throughout our two-year horizon and likely well beyond. The city's broad and diverse economic base also lends stability to the rating, as does the ongoing and sustained recovery from the recession.

Downside scenario

While we would view it as unlikely, any downside risk to the current ratings would most likely be associated with a weaker financial risk profile, such as a rapid and extremely large and aggressive use of debt, perhaps associated with a regulatory mandate. The issuance of senior-lien debt would also likely create a one-notch differential between it and the existing junior lien debt, consistent with the application of our criteria "Assigning Issue Credit Ratings Of Operating Entities", published May 20, 2015.

Ratings Detail (As Of November 29, 2016)		
Phoenix Civ Imp Corp jr lien wtr		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Phoenix Civ Imp Corp, Arizona		
Phoenix, Arizona		
Phoenix Civ Imp Corp WTRSWR		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Ratings Detail (As Of November 29, 2016) (cont.)		
Phoenix Civ Imp Corp (Phoenix) jr lien wtr		
Long Term Rating	AAA/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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